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IN THE

Supreme Court of the United States

OCTOBER TERM 1955

In the Matter

of

Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act of

GENERAL STORES CORPORATION,

Debtor-Petitioner.

v.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS COMMITTEE and WAGE CLAIMANTS,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Questions Presented

1. Whether a corporation irrespective of size, stock distribution, debt structure and financial history has the absolute right to proceed initially under Chapter XI of the Bankruptcy Act by proposing a plan affecting general unsecured creditors.

2. Whether the District Court has discretionary power to determine at the outset that Chapter XI is not avail-

able to a corporation by reason of its size, the widespread diffusion of its stock and its financial history and to direct that such corporation proceed under Chapter X of the Bankruptcy Act.

Statement

The debtor, a New York corporation, filed a petition under Section 322 of Chapter XI of the Bankruptcy Act on October 18, 1954. It proposed, at that time, a plan of arrangement affecting its general unsecured obligations in accordance with the requirements of Chapter XI (R. 13a).

The debtor has an authorized issue of three million shares of common stock. There are 2,232,422 shares of the common stock of the corporation held by some 7,000 stockholders (R. 30a). Its stock is listed on the American Stock Exchange and is actively traded there (R. 30t).

The assets of the debtor are listed at about $5,000,000.00 and its liabilities at about $4,000,000.00 (R. 34a and 35a). For the past five years, the debtor has sustained losses totalling about $4,000,000.00.

Under the name of D. A. Schulte, Inc., the name under which the debtor was originally incorporated, the debtor filed a petition for re-organization under Section 77b of the Bankruptcy Act. Until 1953, the debtor was engaged in the business of operating a chain of tobacco stores. At the time of the filing of the petition under Chapter XI of the Bankruptcy Act, the debtor operated some seventy-six tobacco stores. It appears, however, that as of July 1, 1954, the debtor operated one hundred forty-six stores. Since the date of the filing of the Chapter XI petition, the debtor has liquidated and discontinued operation of all of such stores.

The debtor is also the owner of all the outstanding stock of Stineway Drug Company which operates a chain of twenty-three stores in the Chicago area engaging in the sale of tobacco products, candy, liquor and drug sundries. These stores also operate fountains and luncheonettes. In addition, Stineway Drug Company sells merchandise to twelve independent drug stores which are identified as Stineway System Stores (R. 21a).

Debtor also owns all the outstanding stock of Ford Hopkins Company, a corporation engaged in the operation of a chain of forty-eight drug stores and three restaurants principally located in the City of Chicago.

The purchase price of the Stineway Drug Company stores was $1,220,320.50 of which $800,000.00 was paid in cash at the time of closing and the balance was to be paid by April 15, 1954 (R. 21a). The Ford Hopkins Company stock was acquired at a price of $2,800,000.00 of which $735,000.00 was paid at the time of closing. This down payment was paid in part from the proceeds of a loan from Stineway Drug Company amounting to $440,000.00.

Upon the petition of the respondent, Max Shlensky, the owner of some 3,000 shares of the stock of the debtor, an order was made by the District Court directing the debtor to show cause why the Chapter XI proceedings should not be dismissed unless the petition was amended to comply with the requirements of Chapter X for the filing of a petition for re-organization. The Securities Exchange Commission was made a party to the proceedings commenced by the respondent, Max Shlensky. Subsequently, the Securities Exchange Commission cross-moved for the same relief requested by the respondent, Max Shlensky.

Reasons for Denying the Writ

Despite the assertions of the debtor, the circumstances of this case do not give rise to any unsettled or undecided questions of law. This Court, in *Securities and Exchange Commission* v. *United States Realty & Improvement Co.*, 310 U. S. 434, precluded the unfettered exercise of choice between Chapter X and Chapter XI by corporate debtors. Certain criteria for such choice between Chapter XI and Chapter X were fixed in that case and within the limits so set it rests with the District Court in the exercise of sound discretion to determine whether a Chapter XI petition filed by a corporate debtor is proper or not.

The debtor denies that any such criteria exists in the present circumstances and indirectly states that if such criteria does exist, they are contrary to the provisions of the Bankruptcy Act.

Debtor attempts to distinguish the *U. S. Realty* case and the decision of the lower court in *Mecca Temple* v. *Darrock*, 142 F. (2d) 869, on the ground that in both of these cases the Courts were concerned with public investors in the capacity of creditors rather than stockholders. Any such attempted restriction does violence to the very language of the decisions.

This Court stated (p. 447):

> "While we do not doubt that in general, as will presently appear more in detail, the two chapters were specifically devised to afford different procedures, the one adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other to composition of debts of small individual business and corporations with few stockholders, we find in neither chapter any definition or classification which would enable us

> to say that a corporation is small or large, its security holders few or many, or that its securities are 'held by the public', so as to place the corporation exclusively within the jurisdiction of the court under one chapter rather than the other."

and again:

> "Obviously the adequacy of the relief under Chapter XI must be appraised in comparison with that to be had under Chapter X, and in the light of its effect on all the public and private interests concerned including those of the debtor."

The debtor states that the fact that it has 7,000 stockholders is immaterial. It also considers the fact that it is a corporation with $5,000,000.00 in assets and $4,000,000.00 in liabilities equally immaterial. These are, however, the very facts upon which this case must turn. In the *U. S. Realty* case, this Court expressly stated that the size of a corporate debtor, the existence of public stockholders and the number of such stockholders determine whether or not a corporate debtor properly proceeded initially under Chapter X.

In the more recent case of *In Re Transvision, Inc.*, 217 F. (2d) 243, the Court below by another panel had occasion to pass upon a question substantially identical with the one here presented. In accordance with the decision in the *U. S. Realty* case, the Court below felt itself bound to determine whether there had been a proper exercise of discretion on the part of the District Judge in finding that a Chapter XI petition filed by the corporate debtor was proper. There, however, the Court was dealing with a relatively small corporation with an extremely limited number of stockholders. Although finding in favor of the corporate debtor, the Court below noted (p. 246):

> "In this connection, it may be observed that the more complex the debt structure and diffuse the stock distribution, the greater the likelihood that Chapter XI will not afford adequate protections and the greater the impulsion to relegate the petitioner to the relief afforded him under Chapter X. *Securities Commission* v. *U. S. Realty Co.*, 310 U. S. 434 (1940); *Mecca Temple, Etc.* v. *Darroch*, 142 F. 2d 869 (2 Cir. 1944)."

The need for the safeguards provided by Chapter X are underscored by the facts. The debtor is a corporation with 7,000 stockholders. Management is thus totally divorced from ownership. The debtor's history of losses of over $4,000,000.00 within the past 5 years compels an investigation into management of the business. The manner in which it obtained stock interest in two other large retail businesses also calls for close scrutiny. None of this can be obtained under Chapter XI.

The Antendatory Acts of 1952, upon which the debtor heavily relies, did not serve to modify or alter the criteria fixed in the *U. S. Realty* case and applied thereafter in the *Mecca Temple* and *Transvision* cases. In amending Section 366 of the Bankruptcy Act by deleting the "fair and equitable" requirement, Congress took cognizance of the warning issued by this Court in the *U. S. Realty* case that Chapter XI plans of arrangement would have to satisfy the "fair and equitable" test as fixed in *Northern Pacific Railway Company* v. *Boyd* (228 U. S. 482). This threatened to impair seriously the effectiveness of Chapter XI.

In the Congressional Report which accompanied the amendment to Section 366, it was noted as follows:

> "However, the fair and equitable rule cannot be applied in a chapter XI, XII, or XIII proceeding, if construed as interpreted in Northern Pacific Rail-

way Co. v. Boyd (228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 [1913], and reaffirmed in Case v. Los Angeles Lumber Products Co., Ltd. (308 U. S. 106, 41 Am. B. R. [N. S.] 910, 60 S. Ct. 1, 84 L. Ed. 110 [1939]), without impairing, if not entirely making valueless, the relief provided by these chapters. If so applied, no individual debtor or corporate debtor (where stock ownership is substantially identical with management) under chapter XI, and no individual debtor under chapter XII or XIII can effectuate an arrangement or plan by scaling of debts.

"The fair and equitable rule was never applied in a composition proceeding under the former section 12 of the Bankruptcy Act, which has been replaced by chapter XI, nor is it practicable or realistic to apply it in a proceeding under chapter XI, XII or XIII.

"The amendment removes the 'fair and equitable' provision and by a paragraph added to each of the amended sections it is made clear that it shall not be applied thereunder." 1952 U. S. Code Congressional and Administrative News 1981 and 1982.

By the very language of the Congressional Report, Chapter XI was consigned to its proper role, namely, a procedure for financial relief of small corporations where stock ownership was identified with management. In this connection it may be noted that the effect of the amendment to Section 366 was to give statutory expression to the findings of this Court in the *U. S. Realty* case. This Court noted that even under the former requirements of Section 366 the "fair and equitable" test could be met by continued management preserving going-concern value of a corporate debtor where the stockholders were the managers of the corporate business.

The enactment of Section 328, which was a companion amendment to the amendment of Section 366, was contrary to the claim of the debtor, more than a mere procedural correction. It was a codification of the law of the *U. S. Realty* case. In particular, it wrote into statutory law the grant of discretion to the District Court to determine whether a Chapter XI proceeding was proper or not. Section 328 states: "The Judge may * * * if he finds that the proceeding should have been brought under Chapter X of this Act, enter an order dismissing the proceedings under this Chapter * * *."

The basic question herein involved, therefore, is whether the District Court did abuse its discretion in directing that the proceedings be transferred from Chapter XI to Chapter X. Only by denying the existence of the criteria by which the propriety of choice between Chapter XI and Chapter X was determined can the debtor assign error to the decision of the District Court and the Court below. If such criteria does exist, then the decision of the District Court was proper in every respect.

The debtor warns this Court that as a result of the decision of the lower Court, considerable confusion now exists with respect to the problem at hand. This is not the case. In the *Transvision* case, the Court below, applying the rules set forth in the *U. S. Realty* case, determined that the District Court properly exercised its discretion in denying transfer to Chapter X. Applying basically the same rules, the Court below in the instant case found that the District Court properly exercised its discretion in directing transfer of the proceedings to Chapter X. Significantly enough the debtor does not assert that the decision of the Court below is in conflict with the *Transvision* case.

We note, from the observation of the Court below, that the debtor is "emphatically not the small corporation in

which the calculated risk of the informal Chapter XI proceedings is warranted." The Court below did criticize in some respect the reasoning of the panel which considered the *Transvision* case but this criticism does not place the *Transvision* decision in conflict with the one presently under consideration. On the contrary, the two decisions read together clearly delineate the rules by which corporate debtors may guide themselves in determining whether Chapter XI or Chapter X provides the proper remedy.

In the language of the concurring opinion of Judge Frank, the *Transvision* case extends the relief afforded by Chapter XI to small corporations basically management owned and having possibly relatively few public stockholders. We believe that notwithstanding the criticism voiced by Judge Clark, the *Transvision* case was intended to stand for nothing else. Certainly nothing in the *Transvision* decision is susceptible to an interpretation favorable to the position of the debtor.

On the other hand, the instant case following the decision of this Court and the prior decisions of the Court below preclude the use of Chapter XI by corporations with substantial numbers of public stockholders and with assets and liabilities numbering well past a million dollars.

In the *Mecca Temple* case, the Court referred to "borderline cases" where there is still no "well defined answer".

In the absence of further amendment to the Bankruptcy Act, such "borderline cases" will continue to perplex the Courts, but there is not involved herein a "borderline case". The facts clearly require a transfer to Chapter X. The interest of several thousand stockholders must be protected. It is not enough to state that the debtor only desires to alter its unsecured obligations which should

inure to the benefit of stockholders. The interest of these stockholders can only be protected by invoking all of the safeguards provided by Chapter X.

CONCLUSION

For the foregoing reasons, petition on writ of certiorari should be denied.

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